



# Electronic Tax Administration Advisory Committee

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## Annual Report to Congress



June 30, 2000

**Electronic Tax Administration  
Advisory Committee**

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## **Executive Summary**

This report defines a vision for electronic tax administration. The ETAAC sees electronic tax administration playing a critical role in a modernized IRS, and believes the underlying purpose of electronic tax administration is to be an enabling mechanism that transforms the IRS into a modern financial institution offering taxpayers world-class service. The electronic filing goals established in the Internal Revenue Restructuring and Reform Act of 1998 (RRA 98) represent a meaningful metric to evaluate IRS progress towards achieving this transformation, but the underlying objective remains to improve service to taxpayers by providing them with electronic means of conveniently interacting with the IRS.

In using electronic tax administration to transform itself, the IRS must overcome these critical challenges:

1. Continuing to develop a strategic planning process to achieve goals.
2. Encouraging all professional tax preparers to become Electronic Return Originators (EROs) and convincing them that filing and communicating with the IRS electronically is preferable to other methods.
3. Increasing electronic filing among self-preparers.
4. Increasing electronic interactions between the IRS and businesses, including filing, payment, and communication activities.
5. Forming strategic alliances with businesses, federal government agencies, states, and other organizations to facilitate and promote the growth of electronic tax administration.

The ETAAC has developed a vision of what meeting each critical challenge will look like, evaluated the IRS' progress in meeting its electronic tax administration strategic goals, and identified what the IRS must do to reach this vision.

### **Progress in meeting electronic tax administration strategic goals**

The IRS experienced a large growth in electronic filing in 2000, with a 20.5 percent increase in e-filed returns. Other aspects of the electronic filing program showed excellent improvement in 2000 as well.

RRA 98 set a goal for IRS to achieve 100 percent electronic filing of all returns prepared on computer by both tax professionals and taxpayers alike by 2003. While progress is being made, the ETAAC believes that much work remains to be done to even approach this goal, and it will not be achieved by 2003.

The 80 percent goal for 2007 can be achieved if a growth rate of 19 percent or better is maintained, but the ETAAC does not know if this rate is sustainable. The ETAAC believes new initiatives will be needed to maintain the growth rate at this level, and recommends that the IRS monitor closely the total growth rate for electronic filing in future years.

### **Continuing the Strategic Planning Process**

The ETAAC envisions that the IRS strategic planning process will clearly establish the IRS electronic tax administration strategy with sufficient milestones and performance measures for both the IRS and external stakeholders to evaluate its progress, and envisions that electronic tax administration strategic plans will become part of an agency-wide master plan that seamlessly integrates electronic tax

administration plans into broad agency strategic plans, establishes meaningful performance measures for each goal, and ties resource planning into achievement of strategic objectives.

An effective strategic plan will align the elements of Public Policy, Strategic Planning, Systems Modernization, and Marketing Strategy and Outreach into a single plan. Public policy in particular should support achievement of the electronic filing goals established by Congress in the RRA 98 and be aligned with IRS strategies. Accordingly, the ETAAC makes the following public policy recommendations to Congress:

- The ETAAC strongly supports the administration's proposed \$10 tax credit for taxpayers that e-file because surveys of tax practitioners indicate this will make a difference in e-filing levels. Congress is encouraged to enact this legislation.
- The Internet can revolutionize tax administration and must be part of the IRS' strategies for interacting with taxpayers electronically. These strategies should stress partnership, not competition, with the private sector to achieve its objectives. The ETAAC believes that the private sector is progressing towards offering taxpayers a range of convenient, low- and no-cost e-filing options, and the best action for IRS to take is to promote the most intense competition among private sector companies and pursue policies that allow these companies to reduce unnecessary costs.
- Congress must appropriate adequate resources and authority for pilots and prototypes, enabling a quick response to rapid changes in the electronic commerce marketplace.

The ETAAC envisions that business systems modernization will provide the technology infrastructure necessary to support electronic tax administration business plans, and that technology infrastructure projects will be funded and scheduled in time to support strategic objectives. Developing technology that facilitates the transition to a fully paperless e-filing process is critically essential to the success of using electronic tax administration to transform the IRS to a customer service-based agency.

### **Encouraging all Tax Preparers to be EROs**

The advantages of e-filing should be so overwhelming that professional tax preparers will consider e-filing the preferred way of doing business. To achieve this condition, the IRS needs to pay closer attention to the tax practitioner market, and understand the factors that motivate various types of practitioners to continue or become an ERO. The account management program has strong potential, and could go far in improving its relationship with tax practitioners.

All incentives that apply to professional preparers should be aligned in favor of e-filing. Of particular concern is that the IRS has set standards for EROs that do not apply to professional preparers that file using paper, thus encouraging professional preparers to remain with paper. The ETAAC recommends this inequity be resolved by applying similar standards for all professionals, regardless of filing mechanism. Preparers should not be able to escape standards by filing only paper returns.

### **Increasing Electronic Filing by Self Preparers**

The fastest growing segment of the e-filing population is online filing by self preparers. The ETAAC believes that based on current market trends, taxpayers will soon have several options to prepare and e-file taxes over the Internet at no cost, and that private sector competition will continue to drive prices down. The ETAAC vision is that the formation of business alliances in the private sector will increase competition and provide many options for convenient and free filing for self preparers, and most of these options will be via the Internet as opposed to buying tax software from a traditional retail outlet.

The ETAAC vision of federal and state cooperation is that a single filing transaction can suffice for both federal and state purposes. The current Fed/State e-filing program enables this type of seamless experience for individual filers in a majority of states, and ETAAC commends the IRS for cooperating with state agencies to continue operating a successful Fed/State program. .

### **Increasing Electronic Tax Administration for Business**

The ETAAC believes that a business should be able to conduct tax administration functions electronically as easily as it conducts business functions with another business. Electronic interaction with the IRS should be at the election of the business. To make this vision a reality, the IRS must improve electronic interactions between itself and businesses in a number of areas, including business income tax returns, information returns, electronic employer and financial institution statements, TIN matching, retirement plan requirements, electronic records and communications, and electronic payments.

The ETAAC recommends the necessary enabling legislation and subsequent establishment of IRS and SSA regulations to permit employers and financial institutions to send forms W-2 and 1099 to taxpayers electronically.

### **Alliances**

The ETAAC envisions a cooperative environment between the IRS and external stakeholders that encourages the formation of alliances to achieve objectives. The ETAAC recommends that the IRS adopt a clear strategy for incorporating alliances with the private sector in order to successfully achieve its electronic tax administration objectives.

## **1.0 Introduction**

This report defines a vision for electronic tax administration—electronic interaction between the IRS and taxpayers for tax filing, payment, and related communication. The National Commission on Restructuring the IRS established a vision for the IRS in 1997 in its report, *A Vision for a New IRS*. In 1998, much of that vision was codified into law in the IRS Restructuring and Reform Act of 1998 (RRA 98). Electronic filing, which the IRS has extended to electronic tax administration, was an important part of that vision. Title II of the RRA 98 provided the IRS with the following policy statement with respect to electronic filing:

- (1) paperless filing should be the preferred and most convenient means of filing Federal tax and information returns
- (2) it should be the goal of the Internal Revenue Service to have at least 80 percent of all such returns filed electronically by the year 2007, and
- (3) the Internal Revenue Service should cooperate with and encourage the private sector by encouraging competition to increase electronic filing of such returns.

Recognizing the importance of receiving private sector input to achieving this goal, the legislation further required that the IRS establish an advisory group to provide it with private sector input, and further required that this advisory group report to Congress annually on the following subjects:

- the progress of the IRS in meeting the goal of receiving electronically 80 percent of tax and information returns by 2007;
- the status of the strategic plan to eliminate barriers, provide incentives, and use competitive market forces to increase electronic filing gradually over the next ten years;
- the legislative changes necessary to assist the IRS in meeting such goal; and
- the effects on small businesses and the self-employed of electronically filing tax and information returns.

The Electronic Tax Administration Advisory Committee (ETAAC) satisfies the requirement of RRA 98 to establish a private sector advisory group on electronic filing matters. This report responds to the reporting requirements specified in the RRA 98, and can be valuable to Congress by providing it with private sector insight on:

- progress made by the IRS in achieving the goals established by Congress;
- a vision of how electronic tax administration can transform the IRS into a customer service organization;
- strategic challenges facing the IRS in electronic tax administration; and
- electronic filing impact on self-employed and small business.

### **1.1   ETAAC's Vision of Electronic Tax Administration**

The ETAAC sees electronic tax administration playing a critical role in a modernized IRS, and believes the underlying purpose of electronic tax administration is to be an enabling mechanism that will transform the IRS into a modern financial institution offering taxpayers the type of services they have come to expect from private sector institutions. The electronic filing goals established in the RRA 98 represent a meaningful metric to evaluate IRS progress towards achieving this transformation, but the



underlying objective remains to improve service to taxpayers by providing them with electronic means of conveniently interacting with the IRS.

## **1.2 The Most Critical Strategic Electronic Tax Administration Challenges Facing the IRS**

The ETAAC focused its attention during the past year on identifying the most critical challenges the IRS must overcome to meet its electronic tax administration objectives, and providing private sector advice on defining strategic approaches to meet these challenges. As a result, the ETAAC identified the following critical challenges, and organized itself into subgroups to develop strategies to meet them:

1. Developing a strategic planning process that optimizes the probability of goal achievement.
2. Encouraging all professional tax preparers to become Electronic Return Originators (EROs) and convincing them that filing and communicating with the IRS electronically is preferable to other methods.
3. Increasing electronic filing among self-preparers.
4. Increasing electronic interactions between the IRS and businesses, including filing, payment, and communication activities.
5. Forming strategic alliances with businesses, federal government agencies, states, and other organizations to facilitate and promote the growth of electronic tax administration.

Section 2 contains an assessment of IRS' progress in meeting its strategic goals. Sections 3 through 7 contain ETAAC's recommended strategies for meeting the critical challenges.

## **1.3 ETAAC Members**

The members of the ETAAC were selected by the IRS to represent a broad spectrum of the private sector, including tax preparers, tax software developers, payroll companies, financial institutions, small businesses, state governments, and taxpayers. Appendix A contains a list of ETAAC members.

## 2.0

### IRS Progress in Meeting Strategic Goals

This section evaluates the results of this year's filing season from an electronic tax administration perspective and provides an assessment of IRS's progress in meeting its strategic goals.

#### 2.1 Individual Filing Season Results

Electronic filing growth for 2000 is shown in Table 1. The IRS experienced a large growth in electronic filing in 2000, with a growth of 20.5 percent. This growth is above IRS' projections for the year and requires a re-evaluation of future projections in *A Strategy for Growth*.

**Table 1. Electronic Filing Growth for 2000**

Electronic Returns	2000 Projected returns in millions (for CY2000)	2000 Actual returns in millions (through 5/18/00)	1999 Actual returns in millions (through 5/21/99)	Percent Actual Change
Practitioner	23.7	25.0	21.1	18.7
TeleFile	5.9	5.2	5.7	-8.9
Online	4.0	5.0	2.4	104.4
<b>Totals</b>	<b>33.6</b>	<b>35.1</b>	<b>29.2</b>	<b>20.5</b>

To put the growth achieved in 2000 in better perspective, Table 2 presents the growth of individual electronic tax returns for 1995 through 2000.

**Table 2. Five Year Growth of Electronic Filing for Individual Tax Returns**

Year	Total Returns in millions	Practitioner Returns in millions	TeleFile Returns in millions	On-line Returns in millions	Total Electronic Returns in millions	Percent Change-Electronic Returns	E-file Percent of Total Returns
<b>2000</b>	127.4	25.2	5.2	5.0	35.3 (note 1)	21	27.7
<b>1999</b>	124.9	21.1	5.7	2.4	29.3	19	23.4
<b>1998</b>	122.5	17.6	5.9	0.9	24.4	26	19.9
<b>1997</b>	120.8	14.4	4.7	0.4	19.5	29	16.1
<b>1996</b>	118.8	12.1	2.8	0.2	15.1	28	12.7
<b>1995</b>	116.5	11.1	0.7	0.001	11.8	N/A	10.1

Note 1: Projected number of returns

Also encouraging was the growth of more complex returns. Table 3 shows that more complex returns such as Form 1040 and Form 1040 with complex schedules experienced higher growth rates than simpler return types.

**Table 3. Growth in Complex Returns for 2000**

	1040EZ	1040A	1040	1040 with Schedule C/F
<b>1999</b>	8.4	7.5	13.3	1.8
<b>2000</b>	8.7	8.7	17.8	3.0
<b>Percent change</b>	3.6	16.0	33.8	66.7

Electronic payments are also increased over last year. This year more balance due filers chose IRS *e-file* than ever before and more payments were made electronically. Nearly 2.3 million balance due returns were filed electronically; a 51.3 percent increase over last year. Table 4 shows the growth of electronic payment as of June 2000. Expanded electronic payment options during the 2000 filing season also included accepting credit cards for estimated tax payments and extensions of time to file and direct debit for TeleFile. Direct deposits of refunds made by the IRS were also up 24 percent in 2000.

**Table 4. Electronic Payment Growth for 2000**

	1999			2000		
	Volume	Average \$	Total \$	Volume	Average \$	Total \$
<b>Direct Debit</b>	75,000	\$1867	\$140 million	234,600	\$1616	\$379 million
<b>Credit Card</b>	53,000	\$3448	\$183 million	190,400	\$2871	\$547 million

Finally, EFTPS continues to grow aggressively with 36 million transactions and more than \$986 billion being processed through the system since the beginning of the FY through June 17, 2000. This is a 15 percent increase over the same period last year bringing total EFTPS transactions and dollars since inception to 161 million transactions and 4.0 trillion dollars.

## **2.2 Other Significant Accomplishments During 1999-2000**

In addition to the overall 20 percent growth in e-filed returns, the 2000 tax filing season included several noteworthy events that reflect positively on the abilities of the IRS to successfully administer a growing electronic tax administration program.

The IRS updated its electronic tax administration strategic plan, *A Strategy for Growth*, incorporating a number of recommendations made by ETAAC and other private sector sources to enhance the document, and established it as a leading strategic planning document within the IRS.

The IRS mailed more than 11.5 million postcards with E-file Customer Numbers (ECNs) to people who did their taxes on a computer last year, whether they filed a paper or electronic return. Approximately 1.4 million taxpayers used the ECN when they e-filed, up 112 percent over last year. The IRS also enrolled 18,000 Electronic Return Originators (EROs) in the Practitioner PIN Pilot, more than twice as many preparers as last year. The result was a resounding success with 5.4 million taxpayers participating in the program compared to only 499,606 for all of last year.

The debt indicator pilot project, which provided an offset indicator for e-filed returns requesting a bank product in exchange for closer scrutiny of potential fraudulent returns by EROs, was successful in driving down the cost of bank products and increasing the number of e-filed returns in that market segment.

The number of e-filed returns through the AARP Tax Aide program increased. The number of EROs participating in this program more than doubled from 618 to 1288, submitting a total of 145,733 returns compared with 44,815 in 1999.

Fed/State *e-file* also continued to grow with 11.9 million taxpayers in 35 states and the District of Columbia filing both their Federal and state tax returns in a single electronic transmission.

In order to better coordinate the electronic tax administration approaches in each Business Operating Division, the IRS has established an e-Business Executive Steering Committee to involve all of the Operating Divisions in the planning and execution of the ETA program across all market segments. The steering committee will be responsible for ensuring that consistent strategy, plan and resource allocation decisions are made for the ETA program on a Service-wide basis. The ETAAC regards this as a positive step in unifying the strategic planning efforts of each operating division and the agency as a whole.

Other accomplishments include:

- The marketing campaign to taxpayers was significantly better.
- The Nationwide Tax Forums, aimed at the tax preparer community, were much improved. By introducing an ERO recognition program, the IRS adopted a business standard that will serve them well in the future. This should be considered a beginning, as much more does need to be done.
- The IRS has implemented the new Form 941 On-Line filing program for employers this spring
- The ETAAC recognizes and endorses the efforts to improve the internal systems. Clearly, the effort is only at its beginning, but the consolidation of 11 e-mail systems into one is commendable progress.
- The IRS is beginning to establish an Account Management program including designating National Account Managers as well as piloting Account Management in two district offices
- The IRS has made significant progress in issuing guidance to employers on the use of electronic technologies for administering tax-qualified retirement plans. Specifically, the IRS issued Notices in 1999 and 2000, and a series of regulations in 2000, that provide flexible standards for the use of electronic technologies in a variety of situations.

### 2.3 Progress Towards Meeting Strategic Goals

The RRA 98 established a goal for the IRS that 80 percent of all tax and information returns should be filed electronically by the year 2007. The act further requires that the IRS strategic plan for reaching the 80 percent goal provide that all such returns **prepared** electronically should be **filed** electronically by the 2003 tax filing season.

#### *Strategic Goal for 2003*

The 2003 goal aims to reach 100 percent electronic filing of all returns prepared on computer by both tax professionals and taxpayers alike. While progress is being made, the ETAAC believes that much work remains to be done to even approach this goal, and ETAAC believes this goal will not be met because it would require virtually all professional tax preparers to e-file returns by 2003, as well as all self-prepared returns prepared using computers to be filed electronically. ETAAC believes that insufficient incentives are in place or planned to achieve this magnitude of change in the professional tax preparer community, and recognizes not all home computers have communication capability. In some respects, the goal for 2003 is more difficult than the 80 percent goal in 2007. It is possible, and even likely, that even in 2007 not all returns prepared electronically will be filed electronically, even if the 80 percent goal e-filing goal is achieved.

#### *Strategic Goal for 2007*

Although it is unlikely that the goals for 2003 will be met, developing an electronic filing strategy that attracts all professional tax preparers to become Electronic Return Originators (EROs) is an extremely important goal, and is one of ETAAC's five critical issues that must be addressed to meet the 2007 goal.

The question should not be whether the IRS will meet its 2007 goal, but rather, what types of initiatives and incentives are required to change taxpayer and tax preparer behavior so this goal can be achieved.

The ETAAC believes that more new initiatives and incentives are needed to achieve the 2007 goal. Moreover, it is critical that the IRS develop new initiatives quickly together with a program to evaluate results against established milestones and expectations. The ETAAC is concerned that *A Strategy for Growth*, alone or in conjunction with other IRS planning documents, does not present a complete strategy for achieving the goal. IRS projects that between 49.4 and 70.4 million e-filed 1040 returns in the year 2007. This is far short of the 80 percent goal. However, recent e-filing trends, including the growth of e-filing in the 2000 tax season, give hope that these projections may be understated. The IRS is already working on updating its e-filing projections based on recent filing season results.

The tables in Appendix E of the *A Strategy for Growth* do not show the complete picture. A number of significant returns are missing, including 990, 1120 and 5500. ETAAC recommends all forms of significant quantities be added to the tables, along with a total number of returns, presenting a complete picture of progress.

The two-year request and approval process for Request for Information Services (RIS) and for budgetary resources must be considered in planning to achieve the 80 percent goal by 2007. All final plans and resources for 2007 must be initiated and requested no later than 2005. Hence, from a budget and planning perspective, we are only four years away from the final goal. The IRS must carefully and critically select projects, define information system changes, and budget in each of the five remaining years.

## **2.4     ETAAC's Assessment of the 2000 Filing Season**

This is the second consecutive year that the number of TeleFile returns has decreased. The IRS has not determined the specific causes for this decrease. The ETAAC recommends that the IRS perform an analysis of the factors causing the decrease. Not only should the IRS factor the decrease into future projections, it must determine the future direction of the program.

The growth rate of 20.5 percent is an increase over the growth rate of 19 percent experienced in 1999. The ETAAC does not know if this rate is sustainable, and recommends that the IRS monitor closely the total growth rate for electronic filing in future years. The 80 percent goal for 2007 can be achieved if a growth rate of 19 percent or better is maintained, but ETAAC believes new initiatives will be needed to maintain the growth rate at this level.

Although electronic payments did experience growth, the number of taxpayers using electronic payment options is low. The ETAAC is concerned that electronic filing is still perceived by many taxpayers and professional tax preparers as a filing mechanism for refund taxpayers. The number of balance due e-filers should be monitored closely by IRS, but the ETAAC believes that additional incentives are needed to attract balance due e-filers. Both credit card and ACH payments cost more than their paper counterpart, the former because of processing fees credit card companies charge taxpayers, and the latter because of the time value of money.

### 3.0

## Critical Challenge 1: Developing A Strategic Planning Process to Achieve Goals

### 3.1 ETAAC's Vision of IRS' Strategic Planning Process

The ETAAC's vision of the IRS strategic planning process for electronic tax administration is that A *Strategy for Growth*, the IRS's strategic plan for electronic tax administration, clearly establishes the IRS strategy for achieving its electronic tax administration goals, with sufficient milestones and performance measures for external stakeholders to evaluate IRS' progress.

The objective of the ETAAC's strategic planning effort is to review, with a private sector perspective, the IRS' strategic plan and planning processes relating to electronic tax administration and to assess progress toward achieving the e-filing goals specified in the 1998 IRS Reform and Restructuring Act. The following four sections summarize ETAAC's assessment, accompanied by appropriate recommendations:

- Public Policy
- IRS Strategic Planning
- IRS Systems Modernization
- IRS Marketing Strategy & Outreach to e-File Market

### 3.2 Public Policy

The ETAAC's vision is that public policy should support achievement of the electronic filing goals established by Congress in the RRA 98 and be aligned with IRS strategies. Accordingly, it makes the following recommendations for public policy aligned in support of this objective.

#### *Taxpayer Incentives*

The ETAAC strongly supports the administration's proposed \$10 tax credit for taxpayers that e-file their tax returns. Surveys of professional tax preparers, such as that conducted by the Council for Electronic Revenue Communications Advancement (CERCA) in 1999, show that over 50 percent of tax practitioners believe that a tax credit for a client's e-filed return would have substantial influence in convincing professional tax preparers to e-file. Moreover, the tax credit, if enacted as proposed by the Administration, would put the Congress behind this method of filing tax returns, demonstrating its commitment to using electronic tax administration as a mechanism for providing taxpayers with customer service from the IRS.

Meaningful incentives, such as the \$10 tax credit, will promote e-filing both among taxpayers that use professional tax preparers and self preparers. Tax incentives create customer demand for e-filing that professional tax preparers cannot afford to ignore if they want to retain their clients' business. Incentives also motivate self preparers to e-file. In both cases, the value of e-filing goes beyond savings realized by IRS in processing costs. E-filing gets taxpayers away from manual computation of taxes, an error-prone process at best. E-filing also results in more accurate data in the tax administration system, as error-prone data entry processes are avoided. As a result, far fewer errors are introduced into IRS data files, and the entire tax administration process runs more smoothly from both the taxpayer's and IRS' perspectives.

#### *Internet Strategy*

The Internet has changed many aspects of our culture, and the ETAAC's vision is that it can revolutionize tax administration as well. As the IRS develops more strategies for interacting with taxpayers electronically, the Internet must be an important part of those strategies. The Internet has potential for four tax administration functions—preparation, filing, communication, and payment, and for

all four customer segments—wage and investment; small business and self-employed; large and medium business; and tax exempt and government entities.

In order to provide some additional clarity, the four tax administration functions are defined as:

- Preparation—the interpretation of the tax laws and regulations as they apply to the situation of the individual taxpayer and the completion of the forms required by the IRS. This process results in the actual calculation of the taxpayer's tax liability.
- Filing—the process of supplying the results and information from the preparation process to the IRS. Electronic filing is the process of supplying this information in an electronic form.
- Communication—the exchange of information and dialog between taxpayers or their representatives and the IRS.
- Payment—the transmission of money to or from the IRS to satisfy liabilities or process refunds.

The Internet will be a revolutionary tool for the facilitation of all of these activities. The IRS is in the process of enabling Internet payment and communication systems and ETAAC is very supportive of these efforts. However, for the preparation process there is a highly developed private sector activity encompassing tax preparers, accountants, software providers and outsourcers. Filing is the outcome of the preparation process, and to some extent it is not possible to supply filing without some aspects of preparation. This fact raises a number of issues in regard to how involved the IRS should be in the preparation process given its role as an auditor and reviewer of whether or not the taxpayer has complied with the tax code in determining their taxes. In addition to the appropriateness of the IRS' role, there is also the question of whether the IRS should provide a service that the private sector is already providing.

In developing electronic tax administration strategies for the four customer segments and four functional areas noted above, the ETAAC believes the IRS should stress partnership, not competition, with the private sector and state and local governments to achieve its objectives.

The ETAAC has been most interested in the use of the Internet to provide low- and no-cost Form 1040 tax preparation and e-filing options to taxpayers. The ETAAC supports this objective because it believes it will lead to an increase in e-filing, but recognizes there are several ways to achieve it. The IRS should carefully consider marketplace conditions in developing its plans for achieving no-cost Internet tax preparation and e-filing.

The ETAAC believes that the Internet has already increased competition in the individual tax software marketplace. Although there are primarily two products available to consumers through traditional retail channels, there are considerably more options available to consumers through the Internet. Appendix B, a letter from the ETAAC to the IRS on e-filing over the Internet, contains a list of various web sites that offer e-filing. The ETAAC also sees competition in the Internet tax software marketplace increasing in the next several years. One newly formed company has announced plans to offer free tax preparation over the Internet starting next year, and at least one other already offers it.

Alternatively, the IRS could choose to achieve the goal of no-cost e-filing and tax preparation over the Internet by entering the marketplace with its own product. It could accomplish this either developing a software product internally or acquiring it through a competitive procurement. This approach would represent a significant change in current policy. Currently, the IRS does not provide or approve tax preparation software and the risk for the use of these products lies with the individual taxpayer. A more appropriate approach may be to offer an electronic template or form that allowed taxpayers that already

computed their taxes manually to transmit their returns to the IRS electronically. This approach would try to create a distinction between electronic filing and preparation with electronic output.

A second approach to entering the marketplace would be for the IRS to align itself with a limited number of “authorized e-file providers” that offer no-cost e-filing. This approach would have the effect of limiting competition and reducing the likelihood of new competition in the marketplace. Ultimately, this approach could have the effect of limiting competition and reducing taxpayer choices.

The ETAAC considered the question of how to best meet taxpayer needs. Congress has already established a policy for the IRS that electronic filing should be the preferred and most convenient method of filing tax returns. As more taxpayers use the Internet in their daily lives, some taxpayers seem to want no-cost tax preparation and e-filing over the Internet. The ETAAC believes it is consistent with good public policy to encourage the use of the Internet to provide a complete range of options, including low- and no-cost options, for taxpayers to perform tax preparation and e-filing.

The ETAAC believes that the clear choice of public policy should be to let the private sector provide the capability, with the federal government stepping in if the private sector does not meet the need. The ETAAC believes it is inappropriate at this time to pursue a public policy that would require the IRS to offer no-cost electronic filing over the Internet. The marketplace has made noticeable progress towards achieving no-cost electronic filing over the Internet in the past two years, and additional progress towards this goal is expected next year based on publicly announced plans. The ETAAC believes that any effort by the IRS at this time to enter the marketplace itself, either by developing its own software or aligning itself with a limited number of “authorized e-file providers” that offer no-cost e-filing, would have the effect of limiting competition and would ultimately limit taxpayer choices.

In support of the goal of no-cost e-filing and tax preparation over the Internet, the ETAAC believes that the most appropriate actions the IRS can take to provide taxpayers with a wide choice of low-cost and no-cost tax preparation and filing options over the Internet are to continue to: 1) encourage competition, 2) seek industry views on which barriers inhibit lower-cost to no-cost private sector supplied options, and 3) stimulate electronic filing through its creative advertising campaign and making electronic filing convenient to use through such improvements as the acceptance of additional forms and the elimination of paper. The ETAAC’s recommendations on the use of the Internet for electronic filing are grounded in the belief that competition is the most effective way to provide taxpayers with the widest range of performance and price options for tax preparation and electronic filing. Promoting the most intense competition among private sector companies and pursuing policies that allow these companies to reduce unnecessary costs is the best action the IRS can take in pursuit of the goal of no-cost electronic filing for taxpayers.

The ETAAC also recognizes that the Internet changes rapidly and business models are in constant evolution, and even revolution. The ETAAC believes that a re-assessment of the marketplace should be made in two years to assess whether the range of choices for electronic filing over the Internet includes no-cost options for taxpayers. If no-cost choices do not exist, the ETAAC believes the IRS would then be justified in evaluating, in conjunction with ETAAC, whether an electronic template, or other approach, is an appropriate and needed tool to promote no-cost e-filing over the Internet. The IRS and ETAAC should track progress in meeting this objective on an annual basis.

#### *Budgetary Support for Pilots and Prototypes*

Once an integrated strategic and modernization plan is completed, the ETAAC recommends that the IRS be given adequate resources and authority for pilots and prototypes, enabling a quick response to rapid



changes in the electronic commerce marketplace. This year, a number of planned pilot projects were delayed one year. Pilots and prototypes have an important role in the strategic plan for electronic tax administration. Because of the rapid advances in technology, pilots and prototypes represent an effective method for IRS to test the effectiveness of new technology in tax administration applications, and validate requirements on a small scale for future full-scale development.

#### *Effective Dates for New Tax Laws*

When new tax laws are enacted, the ETAAC encourages Congress to give careful consideration to the proscribed effective dates and the impact these dates have on electronic tax filing. A significant amount of time is needed by tax software developers to rewrite their tax software programs to be in compliance with federal law. In addition, changes at the federal level typically require tax software developers to modify their state tax software programs as well. Otherwise, tax software developers may not be able to timely rewrite their programs and the number of taxpayers that may file electronically may be significantly reduced.

### **3.3 IRS Strategic Planning**

ETAAC's vision is that electronic tax administration strategic plans become one part of an agency-wide master plan that seamlessly integrates electronic tax administration plans into broad agency strategic plans, establishes meaningful performance measures for each goal, and ties resource planning into achievement of strategic objectives. Accordingly, it makes the following recommendations for public policy aligned in support of this objective.

#### *Master IRS Strategic Plan*

The ETAAC strongly encourages the IRS to develop an overall Master IRS strategic plan that incorporates the transition to electronic business management and electronic filing. During its development, the plan should then be synchronized with *A Strategy for Growth*, the IRS Modernization plan, and the plans of the IRS operating divisions into an integrated whole with common goals, objectives and strategies. The ETAAC recommends that each of the operating divisions develop strategic objectives, strategies and operational plans for achieving their component of the electronic filing goals.

#### *IRS Strategic Planning Process*

The ETAAC recommends the IRS begin a process of integrated strategic planning, encompassing ETA, Business Systems Modernization, and business planning for the four operating divisions. The ETAAC believes the planning process should be consistent with the best industry practice for strategic planning.

#### *Integrated Program Management*

The ETAAC recommends that an integrated program management function be established to aid in the effective management, communication and tracking of the modernization efforts, the transition to electronic tax administration, and the reorganization. Additionally, the program management group is seen as assisting in the overall prioritization of initiatives and strategies to achieve the electronic tax administration goals. The ETAAC recognizes that recently established E-Business Executive Steering Committee is a step in this direction.

#### *Operational Planning*

An important element of the planning process is implementation planning. *A Strategy for Growth* contains comprehensive time lines for each identified project; however, there is no discussion of the operational steps, major segments and overall timing. Although operational plans need not be part of a strategic planning summary, having such information is an important step before implementation. The ETAAC recommends the IRS develop the operational plans corresponding to the electronic tax administration projects and share these with the ETAAC.

### *Resource Commitment*

Adequate resources for the projects required to transition the IRS to electronic tax administration by 2007 have not been addressed. It is important for the IRS strategic plan to commit to providing sufficient resources to ensure the necessary systems and services will be implemented on the required schedule. Further, identifying a multiple year resource plan and budget would be a valuable tool in assisting achievement of the overall goal.

### **3.4 IRS Systems Modernization**

The ETAAC's vision is that IRS systems modernization efforts provide the technology infrastructure necessary to support electronic tax administration business plans. Technology infrastructure projects that support electronic tax administration goals must be funded and scheduled in time to support strategic objectives. The ETAAC makes the following recommendations for IRS business systems modernization.

#### *Vision*

ETAAC recommends the IRS develop and publish a comprehensive vision of the modernized systems taxpayers will use to interact with the IRS as a result of modernization. This vision should describe how information will be electronically presented, transmitted, received, routed, acknowledged and accessed by individuals, businesses, and their representatives. This vision document would serve as a road map in developing implementation plans and in communicating with the public and private sector partners.

#### *All Forms & Schedules*

The ability for the IRS to receive nearly all forms and all schedules for all income tax and information returns, including the ability to receive supplemental statements is required for achieving the goal—particularly for those returns currently prepared electronically. Emphasis here is on all forms and schedules, not just schedules of form 1040.

- The ETAAC recommends the IRS develop a time table identifying when each form and schedule (or group of forms and schedules) will be receivable electronically.
- *A Strategy for Growth* places emphasis on 1040 e-filing. While priority rightly is placed on the largest volume returns, including forms 1040, 1099 and W-2, coverage should be extended to other large volume returns, such as corporate, partnership, and non-profit returns.
- The plan currently leaves the implementation of business tax returns (corporate and partnership income tax, and related information returns) until later in the implementation period. If this timing is maintained, neither the 2003 nor the 2007 goals will be achieved. ETAAC recommends acceleration with initial emphasis being placed on those returns currently being prepared electronically.

#### *Electronic Authentication—The Importance of Paperless*

Transitioning to a fully paperless e-filing process is critically essential to the success of using electronic tax administration to transform the IRS to a customer service-based agency. The ETAAC is fully supportive of the alternative signature initiative undertaken by the IRS, including the use of Electronic Control Numbers (ECNs), and recommends that IRS develop an ECN program, whether self-selected or assigned, for all taxpayers that can be used universally for electronic tax administration functions. This action would extend customer service to higher levels.

An alternate to a paper signature has been implemented for individual tax returns, but not for a large number of returns and documents required by the IRS. The ETAAC recommends the IRS enable electronic alternatives for taxpayers to sign all tax documents that now require paper signatures, and

further recommends the IRS place high priority on adopting a comprehensive authentication, security, and privacy policy. In evaluating alternatives, the ETAAC recommends the IRS:

- Complete a risk analysis that weighs potential non-compliance and fraud, for a small number of tax cases, against the benefit to the IRS and the burden reduction for millions of e-filing taxpayers.
- Apply equivalent levels of security, privacy and fraud protection to both e-filing and paper filing.
- Define the appropriate and acceptable levels of security and privacy.
- Establish the degree of certainty that is required for signatures and authentication.

#### *Business Systems Modernization*

The ETAAC recognizes that systems modernization is essential to meeting the electronic filing goals, and is concerned with the one-year delay in planned pilots, including Secure Extranet, Secure Messaging, Taxpayer Identification Number (TIN) Matching, Power of Attorney, Transcripts, and Authentication. Together these represent key incentives in attracting the preparer community that prepares over half of the 1040 returns and a significant number of business and information returns.

The “Building the Foundation” section of *A Strategy for Growth* identifies six areas as priorities for infrastructure development—Authentication, Processing System Consolidation, Performance Analysis, Internet Capabilities, Fraud Prevention and Control, and Annual Maintenance. These priorities are important, but ETAAC believes that other items of equal importance should be added to the list. Some of these are:

- Making the taxpayer tax account database accessible in real time to IRS business application.
- Establishing the strategies for completing the necessary technology development.
- Implementing a common system capability that enables the filing of all types of returns, with all of their forms and schedules, over the Internet.
- Modernizing correspondence with electronic transmission.
- Enabling account access through the Internet for taxpayers, their EROs and other professional representatives.
- Developing and implementing processing systems that can handle substantially higher volumes of transactions.

Although the current modernization plan makes a case for architectural principles, it provides only general guidelines. The timely introduction of a governance process that includes architectural principles and standards (information, data, application, technology and knowledge) should be addressed. The speed with which IT governance and new architectural standards can be introduced is critical to the success of every strategic objective, and needs to be addressed in the context of the technology infrastructure strategy.

#### *IRS & SSA Partnership*

The ETAAC’s vision is that the IRS obtain all information returns in electronic form prior to processing income tax returns, enabling the IRS to match tax and information returns prior to issuing refunds, while maintaining or improving the present refund issuance cycles. Implementing this vision requires a number of changes to tax administration systems, and will take many years to achieve. Under the current system,

Social Security Administration currently accepts the W-2 information from employers, using a method of batch processing information that is now outdated. After this information is compiled, usually sometime in August, all this information is submitted to IRS. Other information returns, such as dividend and interest reporting, go directly to the IRS. Using its own antiquated system, it takes IRS months to process all of the information and match the information returns against tax returns.

As an initial step, the ETAAC recommends that the IRS develop the capability to receive all information returns electronically, and that the IRS implement a program for taxpayers and employers to electronically file forms W-2, 940, 941 and 1099 over the Internet. The ETAAC also recommends that IRS and Social Security Administration work together to design and implement a single database system for use by both agencies, as well as any other government agencies having authorized access to this information. The long-range objective should be to achieve a database that is available during the filing season to accomplish document matching in real time. Ultimately, after the Master Files are updated, the IRS can safeguard income tax returns from refund fraud by matching payroll data with the return prior to making refunds. GAO recently reported that IRS inability to perform document matching costs the government \$15 billion per year, only about \$9 billion of which is recovered.

#### *Differentiated Service*

The ETAAC's vision is that taxpayers will perceive clear benefits to e-filing over paper filing. To achieve this vision, it is important to make e-filing preferable to paper filing in all respects, including taxpayer's perception of compliance checking of paper vs. e-filed returns. The ETAAC recommends that all incentives for filing preference be aligned to provide taxpayers with advantages for e-filing over paper filing, and incentives for paper filing be eliminated. Currently, there are still incentives for taxpayers to file by paper, such as the following examples.

- Data is required on e-filed returns that are not required with paper returns. This can be corrected by requiring the same information on paper returns and e-filed returns.
- The IRS accepts paper returns with SSN errors, although e-filed returns with the same errors are rejected. The IRS should suspend processing of the paper returns with these errors and contact the taxpayer. The current process provides an incentive for taxpayers to file on paper.
- Document Retention—e-filing taxpayers are asked to retain paper copies of their tax returns. ETAAC recommends this requirement be modified allowing taxpayers the option of keeping copies electronically.

Generally, the ETAAC recommends that the modernization efforts in products and services be focused on those that use electronic communications rather than making parallel investments in improving electronic and legacy, paper-based and paper supporting systems.

### **3.5 IRS Marketing Strategy & Outreach to e-File Market**

The ETAAC vision is that the IRS continues to build on current marketing success to make all taxpayers in all market segments aware of the advantages of e-filing. The following recommendations support achievement of this vision.

#### *Advertising and Marketing*

Although the marketing budget for ETA has increased over the past few years, it still remains inadequate. If corporate America were told that it needed to target every taxpayer in America and get each taxpayer to change lifetime habits, eleven million dollars annually, or \$220,000 per state, would not begin to do the job. During the 2000 filing season, the IRS had a great marketing campaign to promote electronic filing. However, it had to severely limit the markets playing the message due to budget constraints. The

ETAAC recommends increasing the electronic tax administration marketing budget so more taxpayers become aware of the benefits of e-filing, and that the IRS look to the private sector for models to determine the appropriate levels of funding for advertising campaigns.

#### *Effecting the Transition*

Based on industry data, the IRS has achieved its goal of making taxpayers aware of electronic filing. What remains is the more difficult task of getting the multiple taxpayer segments to e-file.

- Tax preparers must be convinced that e-filing is effective for their practice and good for their clients.
- Individuals already self-preparing their returns using computer software must be convinced it is in their best interest to e-file, and not just a cost savings for the IRS.
- Individuals who prepare their own returns manually will be the most difficult segment. Convincing them to shift to an electronic method of preparation, and then to an electronic method of filing, will be difficult.
- Specific marketing efforts should be directed at small businesses, identifying the benefits to them for e-filing and inducing them to make the transition.

To be successful, the marketing program must overcome taxpayer suspicions about e-filing, including the security and privacy of e-filing, likelihood of audit, and the disclosure of information not included in the paper return.

#### *Marketing Services*

- Current aggressive marketing strategies for individual taxpayers should be expanded and continued with the emphasis on getting them to actually e-file rather than just creating awareness.
- The marketing plan for businesses should be further developed.
- The marketing plan for attracting the preparer market should be developed. Professionals prepare over 50 percent of individual returns. Attracting this segment is critically important.

Marketing plans should be developed in a process that involves private and public sector stakeholders throughout the planning process so the IRS, states, and companies can work together to define the most effective marketing messages that can be leveraged off each other to maximum benefit.

#### *Distribution Channel Management*

The IRS has placed heavy reliance on Distribution Channel Management as the tactic to getting professional preparers to transition their clients to e-filing. While this approach shows promise, performance measures should be developed to establish its effectiveness in transitioning professional preparers to e-filing. Comparisons should be made with other approaches to motivating the professional and their clients.

The impact of Distribution Channel Management on the effort to transition to electronic filing has not been estimated in IRS plans. The ETAAC recommends this be accomplished.

## 4.0

### Critical Challenge 2:

#### Encouraging All Professional Tax Preparers to Become Electronic Return Originators

##### 4.1 ETAAC's Vision of Professional Tax Preparers

Virtually all professional tax preparers use tax software today because of the conveniences and efficiencies these products provide. Use of tax software is a business decision most tax preparers make automatically. The vision of ETAAC is that the advantages of e-filing should be so overwhelming that professional tax preparers will consider e-filing the normal way of doing business. The recommendations below discuss strategic approaches the IRS can use to achieve this vision.

##### 4.2 The Importance of Professional Preparers to Achieving E-Filing Goals

The ETAAC recognizes the IRS has a challenging task of promoting e-filing to many different "user" groups. From large business to financial and investment companies to small business and individual self preparers, there are many different strategies and incentive programs needed to attract its users to adopt e-filing as the preferred method of filing.

In no single group is there a bigger need for the IRS to attract to e-filing than the tax practitioner market segment. Many tax practitioners still are not registered as EROs. At present, the IRS exercises tighter scrutiny and control over EROs, including the ability to exclude EROs from the e-filing program. The IRS does not have such control over non-EROs.

While the IRS is busy implementing strategies to serve other segments, tax practitioners often feel that their tax businesses are being threatened. For example, the free Internet filing promotion to the self-preparer market intimidates many tax practitioners. They see clients moving to the Internet and e-filing. Real or not, many practitioners view this action as an effort to take their clients away from them.

The ETAAC firmly believes that the IRS needs to pay closer attention to the tax practitioner market, to evaluate their needs and to allay their fears, real or perceived, about continuing as or becoming an ERO. The account management program is an excellent program, and could go far in firming up the relationship with tax practitioners. The delay in expanding the account management program could delay the conversion of tax practitioners to EROs.

Until this relationship with tax practitioners is at least improved, it is extremely unlikely that the IRS can meet the 80 percent goal, as professional practitioners prepare 56 percent of all individual tax returns. Therefore, the ETAAC strongly recommends the following recommendations be implemented.

##### 4.3 Professional Incentives

Two years ago, the IRS proposed a concept for a step-incentive program to get professionals to e-file their tax returns. The ETAAC strongly recommends that the IRS move forward with this strategy at the earliest possible date to start delivering value-added services to the EROs based on e-filing participation.

The ETAAC vision of this program is consistent with the IRS vision. ETAAC believes that such a program would have multiple categories or levels of participation, with higher levels earned through achievement of performance and linked to additional benefits. Category titles for various levels have already been suggested by the IRS: Bronze, Silver, Gold, and Platinum. At the basic (Bronze) level of participation, there would be no minimum requirements, and all EROs would enter at this level. Providing an entry level removes any barriers to joining the e-file program. Higher levels would be achieved through years of service and percentage of eligible returns e-filed.

ETAAC believes that all new e-services should only be available through the e-file system for returns that are e-filed. Benefits at the higher level would include features that the professional tax preparer community regards as desirable, such as limited power of attorney and electronic account resolution. Linking benefits such as these to the upper levels of the step-incentive program would encourage professionals to e-file their returns and provide incentive to start e-filing now to meet the requirements when these benefits are finally available.

#### **4.4 Creating Parity Between EROs And Paper Return Preparers**

The ETAAC believes that to make e-filing the preferred method of filing for all professional tax preparers, all incentives that apply to professional preparers should be aligned in favor of e-filing. With regard to regulation of preparers, the IRS has actually set standards for EROs that do not apply to paper return preparers. The ETAAC recommends this inequity be resolved by applying similar standards for all professional, regardless of filing mechanism. The standards that protect both the IRS and taxpayers alike should be extended to all preparers.

The IRS sets regulatory standards for EROs through Publication 1345, but there is no equivalent standard for preparers of paper returns. The ETAAC recommends that the IRS close the gap between standards for preparers of paper and e-filed returns. In order to help close this gap, a complete revision of Publication 1345 is needed, with a goal of bringing all practitioners into compliance with federal tax law and ethics practices. Preparers should not be able to escape standards by filing only paper returns.

Under the current regulations, practitioners fear that they can be deprived of their livelihood because they choose to embrace e-filing. If regulations are extended to all professional preparers as recommended by ETAAC, EROs will not be subjected to higher standards just because they are EROs. In any case, ETAAC recommends that suspension handling for any preparer should be timely and equitable.

#### **4.5 Mentoring**

As part of the ETAAC's future vision of universal acceptance of e-filing by tax preparers as the normal way of doing business, the ETAAC recommends that the IRS establish a voluntary mentoring program to assist tax preparers to institute electronic filing procedures into their practices. There are many barriers to becoming a new ERO, and getting a grasp of e-filing procedures is a major hurdle to cross. Current EROs have overcome the "learning curve" and incorporated office procedures to facilitate efficient processing of electronic returns. New EROs would greatly benefit from the experience of these professionals through a mentoring program.

An incentive consideration for an ERO to assist in taking the time to assist a new business could include continuing education credit, an additional "step-up" in the step-incentive program, a link on the Digital Daily, or other incentives as IRS may identify in the future.

Many tax preparers are still unaware of the mechanics of e-filing. The ETAAC's concept is that mentors would be available on a one-on-one basis before the filing season, helping the new ERO understand the process, working with the staff in learning e-filing procedures, as well as helping via telephone or e-mail during the tax season to troubleshoot problems or answer questions. The success of the mentoring program will work well, as experienced e-filers will be showing others how it is done. This program would take advantage of the wealth of knowledge that IRS officials cannot give, and publications cannot explain.

#### **4.6 Practitioner Association Consortium**

The 1040 e-file program has been successful, largely due to practitioner involvement, and promises to be one of the prime factors in e-file's continued growth in the future. Practitioners desire to have input into the evolution of the e-file program, relating to both the individual and business filing programs.

In the past, IRS has sought practitioner input through advisory groups such as the ETAAC, as well as at IRS seminars and utilizing focus groups. While this effort is to be commended, it also needs to be recognized that not all practitioners have the same needs and desires. It is important that the IRS continue seeking practitioner input and even expand its ability to obtain input from a wider subset of practitioners.

One of the best mechanisms to obtain practitioner input is through practitioner associations that represent their members. There are four national associations that represent a significant number of practitioners with diverse practices and backgrounds—the American Institute of Certified Professional Accountants, the National Association of Enrolled Agents, the National Association of Tax Practitioners and the National Society of Accountants, with each association representing a segment of the professional tax preparer community. These associations and their membership represent a broad spectrum of practitioners including those who are governed by Circular 230, as well as those practitioners who are not. It is important to the success of future IRS e-file programs and enhancements that all practitioners are heard and their advice sought.

The ETAAC encourages the formation of a tax practitioner alliance to speak to the IRS with a single voice. Since tax practitioner associations regularly survey their members to obtain information regarding various topics, this relationship could also provide data to the ETAAC and the IRS in significant numbers to provide guidance on new proposals, programs and enhancements relating to e-filing. The ETAAC believes that it would be a great benefit to future ETAAC committees to have a liaison from the ETAAC attending the consortium meetings who would report back to the ETAAC committee as a whole.

#### **4.7 Debt Indicator Expansion**

The ETAAC recommends IRS expand the debt indicator that was piloted this year to include returns that do not include a bank product. EROs could be proactive with their clients if they received this information of a refund offset at the same time as the acknowledgment of the return. This would enable taxpayers to immediately contact the respective agency and resolve debt issues. The ETAAC believes this would be a value-added client service and incentive for paid preparers to e-file returns.

#### **4.8 Using Other Organizations to Drive e-File Demand**

The ETAAC recommends there be a check box included on electronic 1040 returns by which the filer could authorize other government agencies to obtain information from the IRS directly. This authorization would reduce the taxpayer burden associated with filling out other government forms, such as the FAFSA form that needs to be filled out for college students. Including a FAFSA check-box would get all colleges, universities, and technical schools to promote e-filing, as it would vastly improve correctness of the FAFSA forms.

Similarly, if e-transcript delivery were only available to banks and others desiring credit information for loans if the return were e-filed, all financial institutions would promote e-file. The IRS could then avail itself of free advertising and promotion with definite value-added service to the taxpayer, with no appreciable cost. These types of alliances could result in financial and learning institutions actively promoting e-file with their customers.



## **5.0**

### **Critical Challenge 3: Increasing Electronic Filing Among Self-Preparers**

#### **5.1 ETAAC's Vision of Self Preparers**

The fastest growing segment of the e-filing population is online filing by self preparers. The ETAAC believes this growth is indicative of an increasingly higher number of taxpayers using computers to prepare their taxes. The ETAAC believes that based on current market trends, in several years taxpayers will have a multitude of options to prepare and e-file taxes over the Internet for free. By 2007, the ETAAC vision is that the formation of business alliances will provide many opportunities for convenient, low- and no-cost filing for self preparers, and most of these opportunities will be via the Internet as opposed to buying tax software through a traditional channel.

This section recommends strategies to the IRS aimed at increasing electronic filing among self-preparers to at least 70 percent. Based upon calendar year 1999 filing data, the self-preparer population represents 55 million returns from which just 8.2 million (14 percent) were e-filed, which includes 5.6 million TeleFile returns. None-the-less, the self-preparer segment is today and will continue to be a significant population the IRS must consider.

Projecting out to 2007, IRS estimates 60 percent of the nearly 139 million returns expected will be prepared by paid practitioners leaving about 64 million returns to be self-prepared. To achieve 70 percent e-filing by this population, 45 million returns will be required. The upward trend in the use of paid practitioners has been experienced for the past several years and is expected to continue. The ETAAC believes this is based in part on the complexity of the tax code as well as a convenience for time-challenged taxpayers.

#### **5.2 Attracting Self Preparers to e-File**

The number of taxpayers that prepared and e-filed their own returns grew dramatically this year. Not surprisingly, the program remains most attractive to refund filers. A variety of payment options for balance due filers will encourage this population (estimated at 25 percent of taxpayers) to use e-file.

The question the IRS must answer is why people still mail in paper returns? A survey by International Data Corporation (IDC) shows that there is no single strong reason for not filing online. Of those still mailing returns, 18.7 percent don't want to pay for electronic filing, 13.3 percent don't know how to do it or their tax preparer doesn't offer the option, 8.0 percent don't want the IRS to get it sooner, 7.2 percent don't know electronic filing is an option, and the remainder just don't see the need to do so. Interestingly, in the IDC survey, security concerns were minor compared to the reasons above.

However, in a poll conducted for the AP by ICR of Media, PA, 36 percent suggest privacy concerns are a worry. Younger filers (18 to 34 years old) tend to worry less but even among this population of taxpayers, the concern is high. Attracting self-preparers to e-file will be assisted:

1. a temporary, refundable tax credit of \$10 for e-filing of individual income tax returns, and
2. one or more low- or no-cost options for preparing and filing individual income tax returns over the Internet

The ETAAC supports the \$10 tax credit for taxpayers who e-file individual income tax returns.

The ETAAC believes that low- or no-cost tax preparation and electronic filing over the Internet for individuals would benefit taxpayers and lead to an increase in electronic filing. Therefore, ETAAC supports this objective, but is concerned that the IRS might attempt to achieve the objective either by competing with the private sector or reducing competition from the private sector. See Section 3 and Appendix B for a fuller discussion of these issues.

As to the other issues surfaced in the IDC survey, ETAAC believes the IRS commitment to aggressive marketing to taxpayers and practitioners will continue to show positive results. The ETAAC supports these initiatives and encourages the Congress to appropriate sufficient funds to allow IRS marketing campaigns to continue and expand.

### **5.3 State Participation**

The ETAAC vision of federal and state cooperation is that a single filing transaction can suffice for both federal and state purposes. The current Fed/State e-filing program enables this type of seamless experience for individual filers in a majority of states, and ETAAC commends the IRS for cooperating with state agencies to continue operating a successful Fed/State program. Of the few states that operate independent e-filing systems, most work closely with software developers and online filing service companies so that state calculations typically are integrated into a single tax preparation experience even though separate e-filing transactions are required. Thus, from a technology perspective, taxpayers in virtually all states where income taxes must be paid enjoy the benefits of a seamless and convenient e-filing program.

Consistent with the objective to evaluate and recommend strategies that can be used by the IRS to increase e-filing among taxpayers that prepare their own returns, in early 2000 the ETAAC enlisted the assistance of the Federation of Tax Administrators (FTA) to survey state revenue agencies. More than 20 such agencies responded to a FTA questionnaire that asked states to describe initiatives implemented to attract self-preparers to e-file. Most responding states indicate that the percentage of taxpayers who self-prepare returns is within a few points of the federal percentage of 44 percent. However, a few states have observed that self-preparers constitute as many as two-thirds of their filing population.

Most state revenue agencies are part of the IRS Fed/State e-filing program; only 5 states operate independent e-filing programs with some states offering both options. Thus, the vast majority of states are closely tied to the broad strategies used by the IRS to attract taxpayers to e-file. However, according to the FTA survey administered on behalf of ETAAC, the efforts in some states to attract self-preparers to e-file go beyond those used by the IRS. These include:

- “broadcasting” (mass mailing) of e-mail messages directly to various taxpayer segments, especially college students;
- hosting “mall days” in major shopping centers to inform the public about e-filing options;
- offering free State-sponsored or State-operated web-based tax preparation and e-filing;
- providing a state PIN to authenticate the e-filing transaction;
- inserting “stuffers” in utility bills, state employee pay warrants and other targeted taxpayer segments;
- building of an Internet filing portal for self-preparers who use commercial tax preparation software to calculate their return and who prefer to transmit directly to the state via the Internet (instead of through a commercial online filing company); and

- A few state revenue agencies have allocated budget resources to purchase radio, television, highway billboard and other advertising to attract taxpayers to e-file. There is growing interest on the part of some states to explore cooperative marketing and advertising campaigns with the IRS so that federal and state campaigns do not overlap.

The ETAAC commends the IRS for its innovative Fed/State e-file program that makes it possible for states to conveniently obtain taxpayer information, e-filed via the IRS system. At the same time, the ETAAC encourages the IRS to expand its efforts to cooperate with state agencies in the design and implementation of marketing campaigns designed to attract more self-preparers to e-file. One specific initiative of potentially high value to state agencies is the use of the Electronic Customer Number (ECN) that taxpayers may use to authenticate their federal e-filing transaction. For 2001 the IRS has indicated it will not provide ECNs to state agencies for use in state e-filing programs. Other cooperative Fed/State efforts could include co-funded advertising campaigns.

#### *Other tax programs*

Beyond filing transactions for individuals, federal-state cooperation on electronic tax administration matters has been very limited, with few “experimental” efforts to point to in the examinations (audit) and collections arenas. In addition, as yet there is no plan on the part of the IRS to develop and implement Fed/State corporate, partnership and employer tax filing programs. Given the wide variety of business tax programs that operate at the state level, it is reasonable to defer development activity in this area until the IRS is better prepared to move forward with plans to institute business tax filing programs at the federal level.

#### **5.4 Other Initiatives to Consider**

Approximately 25 percent of all form 1040 tax returns filed are prepared by hand. Of these only a small percentage are prepared by a paid preparer. Special attention and programs need to be developed to transition the self preparer with a pencil to e-filing. The following recommendations all provide additional help to self preparers that are not aware of the benefits of e-filing:

- At least during the tax filing season, the IRS should improve its Digital Daily homepage or establish a separate e-file website to make it easier for taxpayers to hyperlink to commercial online services. Current navigation on the Digital Daily requires too many “clicks” to find useful information targeted to self-preparers, and linkage to commercial sites is not as seamless as it should be to attract increasing numbers of self-preparers to initiate and complete an online filing transaction.
- The IRS should revamp its tax booklets that are sent to self-preparers, especially those who qualify for low/no cost e-filing through commercial online services, to more aggressively promote the advantages of e-filing. Booklets should be designed primarily to induce self-preparers to e-file, rather than promoting paper filing. The ETAAC recommends the IRS study state experiences in modifying or eliminating tax booklets sent to taxpayers, such as the elimination of paper forms in the tax booklet, making these forms available only upon request.
- The IRS should increase efforts to establish its outreach program to employers who are considering offering e-filing services to employees. Especially for large employers, the IRS could play the role of a catalyst broker bringing together employers and tax preparation/e-filing companies.

## 6.0

### Critical Challenge 4:

#### Increasing Electronic Interactions Between The IRS And Businesses, Including Filing, Payment, And Communication Activities

##### 6.1 ETAAC Vision of Business-Related Electronic Tax Administration

Many businesses have already begun using e-commerce to conduct business with other businesses or consumers. The Internet has sparked a business revolution that many observers believe is just beginning. The ETAAC's vision for electronic tax administration is simply this—a business should be able to conduct tax administration functions over the Internet as easily as it conducts business functions with another business.

The ETAAC reviewed, within the context of the private sector business community, the IRS' initiatives and progress relative to the electronic tax administration objectives and e-filings goals specified in the RRA 98. The importance of electronic tax administration in this context includes the following:

- From the standpoint of revenue collected and returns filed, the business community represents a large proportion of the taxpayer community. In the most recent *ETA Strategy for Growth*, several of the Business goals for 2007 were highlighted:
  - 7.4 million forms 941 and 1.2 million forms 940 received electronically or on magnetic media
  - 1.5 billion information returns received in non-paper form
  - All of the top 22 payroll service providers file Forms 941 and 940 electronically
  - All of the top 1,000 financial institutions file Forms 1099 electronically
  - 75 percent of the Fortune 1000 file their business tax returns electronically
- Accuracy and automation of business returns and some reporting, for example, greatly improves the overall timeline and efficiency of the individual return process.
- Recognition that from a taxpayer perspective the business returns are an important pre-requisite to the individual tax filing.

In order to achieve the vision of making electronic tax administration as easy as electronically interacting with another business, the ETAAC has made recommendations in the following areas:

- Business Income Tax returns
- Information Returns
- Electronic Employer & Financial Institution statements
- TIN matching
- Retirement Plan Requirements
- Electronic records and communications
- Electronic Payments

##### 6.2 Business Income Tax Returns

Electronic filing of corporate income tax returns is one of the last items that the IRS is going to undertake. Since businesses tend to be, on average, more technologically sophisticated than other taxpayers, this may be an opportunity for the IRS to receive a significant portion of this type of tax return in electronic format. Therefore, it may be worthwhile for the IRS to reconsider when it can undertake the

challenge of receiving electronic filing of corporate income tax returns and permit this type of filing at an earlier date.

### **6.3 Information Returns**

With the recent implementation of the Filing Information Returns Electronically (FIRE) system in November 1999, the IRS has made great strides in the ability to electronically process information returns. The Martinsburg Computing Center (MCC) has received 185 million records via the new system and should finish the year with approximately 200 million records, representing a 66 percent increase over last year's returns. Many benefits are derived, including accuracy and timeliness for IRS/MCC processing and notices of acceptance within two workdays.

While these upgrades have provided a foundation for reaching the business goals for information returns, the ETAAC recognizes that more needs to be done, particularly for the large filers of Forms 1099. The ETAAC encourages further development of the FIRE system such that larger transmissions can be accommodated via a secure, higher speed interface. Utilizing Internet-based protocols as developed in the secure messaging pilot, and leveraging the IRS work to date in authentication (1040 PIN and ECN pilots), a secure, higher-capacity system capability is recommended. Section 3 presents a fuller discussion on the need to receive information returns electronically as a first step in improved document matching.

### **6.4 Electronic Employer & Financial Institution Statements**

The ETAAC recommends the necessary enabling legislation and subsequent establishment of IRS and SSA regulations to permit employers and financial institutions to send W-2, and 1099 forms to taxpayers electronically. Taxpayers should provide prior consent to the electronic delivery, and this consent should be permitted to be provided electronically with "click-through" acknowledgement of the consent.

Two benefits will be derived. First, employers will derive a substantial burden reduction with the elimination of paper handling. Secondly, and equally important, supplying tax return related information to employees electronically would facilitate the employee's own electronic filing.

### **6.5 TIN Matching**

The ETAAC supports and encourages the creation of an IRS TIN matching system. Such a system will provide filers of information returns a means to verify taxpayer name and identification number combinations prior to reporting that information to the IRS. Having access to a TIN matching system will enable filers to file more accurate information returns and will lower the overall cost of payer compliance. In addition, Form 1099 recipients (payees) will also benefit by receiving more accurate information returns that will properly reflect revenues received and funds withheld.

The IRS TIN matching system should be consistent with the Social Security Administrations (SSA) "EVS" system (i.e., user interface, security, name matching logic). A submission of a name and TIN for an individual to the IRS system should produce the same result as if the record were submitted to SSA system. The ETAAC believes that coordination and consistency between the IRS and SSA will provide both immediate and long-term benefits to all, leveraging the SSA work in progress, including a solution that takes advantage of a secure, Internet based interface.

With an online TIN matching system, payers will incorporate the matching process into their account set-up or modification procedures as a way to verify TIN are received from payees. With an instantaneous notification through the TIN matching system, payers can pursue and correct name/TIN problems prior to issuing an incorrect Form 1099 and thereby avoid the later receipt of a B-Notice.

## **6.6 Retirement Plans**

The IRS has made significant progress in issuing guidance to employers on the use of electronic technologies for administering tax-qualified retirement plans. Specifically, the IRS issued Notices in 1999 and 2000, and a series of regulations in 2000, that provide flexible standards for the use of electronic technologies in a variety of situations. In addition, the IRS business plan for 2000 anticipates guidance for the use of electronic technologies in administering plan loans and distributing “notices to interested parties” of IRS determination letter filings.

The ETAAC recognizes the benefits that electronic technologies provide to both employers and employees, and recommends that the IRS continue to facilitate the use of electronic technologies in retirement plan administration. Specifically, the ETAAC recommends the IRS provide guidance on recordkeeping requirements, the electronic distribution of participant notices required under section 204(h) of ERISA, and the applicability of previous guidance to plans established under sections 403(b) and 457 of the IRS Code.

## **6.7 Electronic Records and Communication**

The ETAAC envisions that in the future all communications between the IRS and business could be electronic if elected by the business. The ETAAC recognizes that electronic delivery of notices would provide benefits to the taxpayer community, protect transaction and information integrity and quality and accelerate overall delivery time. Taxpayers and service providers would be able to identify problems and take corrective action within one day of a tax filing, instead of several weeks in today’s environment. This would reduce IRS notices significantly.

The ETAAC also recommends expansion of on-line access to authorized taxpayer return information. Many letters to the IRS are necessary only because the service provider must rely on IRS personnel information retrieval, and further economies and benefits will be derived by direct online availability of account information.

## **6.8 Electronic Payments**

The IRS has made substantial progress in creating an electronic money movement system (EFTPS) for business tax payments and some individual payments. This system currently moves approximately 93 percent of all the funds collected by the IRS. The IRS has also done an excellent job of shifting this program from a mandated activity to a voluntary one, and demonstrating that taxpayers will use an electronic system voluntarily if it offers convenient and efficient features. As part of this shift, the IRS has learned the value of focusing on the benefits to the taxpayer and the IRS versus a more rigid regulatory requirement approach. The IRS is to be commended for this change.

The ETAAC recommends that the IRS take EFTPS to the next level of sophistication by focusing their efforts on how this system can be used more effectively by the tax preparation and filing infrastructure community. This community is composed of accounting firms, service bureaus, banks, and software providers. These are the businesses that will create the tools for electronic filing.

This community is very familiar with the need for systems that can deal with both data and dollars. Today EFTPS is a dollars only system and filing is primarily a data collection and calculation application. This community has already experienced the problems and the time and effort that has to be expended when data and dollars have to be merged and reconciled. As the IRS focuses on filing systems (data), the opportunity exists for a public private collaboration to ensure that the data and the dollars are handled in an all-encompassing process versus multiple systems. For example, prior to EFTPS, the IRS provided a means for payroll services to estimate and overpay tax deposits on behalf of their clients, so

that minor post-deposit date adjustments could be made without penalty. Just as thousands of businesses routinely overpay tax deposits to establish a “buffer” for anticipated adjustments, payroll service providers were able to overpay lump-sum final tax deposits for each quarter, and utilize a five-day adjustment window to reconcile taxpayer deposits and data. EFTPS has no similar mechanism. To protect taxpayers from unnecessary penalty notices, EFTPS should be enhanced to restore this capability.

The ETAAC recommends that the IRS establish a joint task group with representatives of the filing community to address how the IRS can couple EFTPS with the commercial sector's filing and preparation processes to create a collaborative system that will effectively handle both data and dollars. In addition, the task force could consider solutions for account resolution capabilities, such as confirmation of non-filing for seasonal businesses, and corrected taxpayer information to resolve un-postable EFTPS deposits.

## 7.0

### Critical Challenge 5:

#### **Forming Strategic Alliances with Businesses, Federal Government Agencies, States, And Other Organizations to Facilitate And Promote the Growth Of Electronic Tax Administration**

##### **7.1 ETAAC Vision for the Alliance Programs**

The ETAAC envisions a cooperative environment between the IRS and external stakeholders that encourages the formation of alliances to achieve objectives. The ETAAC recommends that the IRS adopt a clear strategy for incorporating alliances with the private sector in order to successfully achieve its electronic filing objectives. The strategy must be clear to all participants and offer fair compensation for all participants who make an investment in assisting IRS meet its goals. In the technology field, it is customary to have many alliances to achieve the desired result. The ETAAC recommends the IRS develop its alliance strategy using a similar approach. The following are some of the elements that should be considered for incorporation into the strategy:

- Documented Alliances programs that outline the expectations for each program
- Certification program for Alliances
- Testing lab for Alliances who have built interface programs to the IRS
- Recognition program to honor those Alliances who achieved the desired result
- Shared co-development efforts with Alliances (such as early release of planned projects and scope of such projects).
- Approved Alliance partners to be listed on the IRS web page so that taxpayers would know that they were certified to do business with the IRS.
- Co-branding certification emblems (such as the e-file logo, only with more significance).

The IRS should make an effort to find and align itself with firms that could act as a distribution channel for its electronic filing programs. This would help IRS reach a massive taxpayer audience quickly. IRS needs to recognize that the private sector already has relationships with the taxpayers and this should be capitalized on.

##### **7.2 Embracing Private Sector Partnerships**

The ETAAC envisions a future where the IRS embraces partnership with the private sector to achieve its objectives. The IRS has expressed more interest in partnering with the private sector in recent years, and the ETAAC encourages continued emphasis on partnership with external stakeholders such as the private sector.

###### *Criteria for Success*

The ETAAC believes that the 2007 goals established by Congress can only be achieved if the IRS adopts a policy of embracing private sector participation in the solution. The importance of private sector involvement was further stated in Congressional policy, "The Internal Revenue Service should cooperate with and encourage the private sector by encouraging competition to increase electronic filing of such returns." To date, the IRS has not identified its vision of the private sector's role in electronic filing specifically, or generally in the transition to electronic tax administration. The ETAAC recommends this be accomplished.



### *Establishing Guidelines and Defining Responsibilities*

To enable individual and business taxpayers to conduct their tax filing and related business activities electronically, all IRS systems must be modernized. As the process continues for redefining taxpayer services, the ETAAC recommends that the IRS establish and publicly announce a process and guidelines for determining which modernization services and projects will be:

- Developed by the IRS at taxpayer expense, either internally or through contracting.
- Left to the private sector at private sector expense and investment.

At the earliest reasonable time, the currently identified services and projects should be placed into one of these categories and publicly announced. Further, the IRS should develop and communicate a comprehensive schedule for the planned availability of each new service.

Armed with this information independent private sector providers and potential partners would be able to plan their investment activities, complimenting the IRS plans. To the extent practical, the private sector should be encouraged to respond with private investment and control in preference to internal control and funding.

### *Encouraging Private Sector Participation*

The ETAAC recommends the IRS expand its plans to effectively engage the private sector in the modernization effort. Some of the key areas include the following.

- Expand the techniques used to achieve additional participation by the private sector in enabling e-filing.
- To the greatest extent possible, participation by those interested should be encouraged. Standards adoption is an essential element.
- Create an Internet strategy that stimulates the private sector to develop and expand filing alternatives for taxpayers and that does not stifle private sector competition and development.
- Establish and publicize the roles the software industry, tax processors and preparer community are envisioned to be asked to play in the implementation of the strategies and initiatives.
- Fully describe the evolving mechanisms for identifying new projects for pilot implementation and evaluation.
- Adopt national and public sector standards for electronic transmission of tax, financial and information data to encourage and facilitate private sector development and support. With the growing broad acceptance of XML as the preferred data encapsulation standard, serious consideration should be given to the adoption of XML as the data standard.

## **7.3 Use of the RFA Process**

In part, the benefit of the RFA process is that it allows for innovative solutions in a non-monetary manner that provides additional flexibilities than the government's traditional procurement process. At the same time, the IRS has been criticized by industry for an RFA process that is viewed with some skepticism. At issue are matters of fairness, clarity of objectives and expected outcomes, ambiguity surrounding future opportunities and protection of intellectual properties.

For an RFA process to succeed, it must take the following into account:

- There must be standardization of the RFA notification process including response time frames, communication of modifications to the original RFA, and selection methodology.
- The IRS must offer industry clear and concise information regarding the future expectations for the program that encourage participation by industry. This information includes such issues as exclusivity, duration, use, and ownership of the developed systems and procedures.

The ETAAC recommends the IRS develop and adopt regulations for RFA creation, administration, award and review that encompass these elements for success.

#### **7.4 Managing “Pilots” To Engage Potential Alliances**

Consistent with the goal to partner with the private sector in achieving e-filing goals, the ETAAC recommends that the IRS expand its current RFA process to:

- annually solicit conceptual proposals from prospective partners to address specific business objectives;
- engage with partners in the creation of partner selection criteria that encourages broad participation while respecting the potential proprietary nature of conceptual proposals;
- develop and define pilot programs based on conceptual proposals;
- select more partners to participate in pilot programs;
- establish success factors and performance measures that are agreed upon by selected partners; and
- evaluate pilots quickly to determine potential for expansion.

Furthermore, as the Service continues to “stand up” its four organizational divisions and further defines the process for incorporating ETA expansion efforts in those divisions, pilots should be undertaken in several divisions annually. Overall management of the pilot programs will require the IRS to devote a greater focus and perhaps additional resources to ensure successful transition from the pilot phase to full-scale production. This investment is closely aligned with research and development efforts in the private sector, and holds the potential for faster and more creative ETA expansion efforts.

#### **7.5 Transitioning from Pilots to Production**

The ETAAC recognizes that many of the systems and approaches for electronic tax administration will originate from small scale pilots designed for a) proof of concept, b) validation of market acceptance, or c) real world experience on issues involving scalability, feasibility, cost effectiveness and security. The ETAAC recommends that the following guidelines be used in managing pilots and transitioning them to production.

- Pilots should run no longer than one tax-filing season.
- Immediately after the end of the pilot phase, the IRS should meet privately with the service provider(s) participating in the pilot. Jointly the IRS and the service provider(s) will evaluate the success of the pilot versus the criteria that were established at the beginning of the pilot.
- If the pilot were deemed to be successful, the service provider(s) and the IRS would jointly develop a high level description of the service configuration. Heavy emphasis in the document should be placed on the interface between the service provider and the IRS (e.g., file formats, transmission protocols). The document should also outline any minimal requirements for service provider qualifications.

- Prior to rollout, the document would be circulated to potential providers and interested parties seeking recommendations that will make the specifications acceptable to the broadest group feasible. These recommendations would then be considered for incorporation into the final specifications.
- It will be understood that the service provider may consider some of the details regarding the taxpayer interface to the system proprietary and therefore this information may not appear in the document.
- The service description document should then be circulated to possible providers of the service for comment and input.
- The document would then be presented to all interested parties for national roll out. It is our belief that service providers will then be able to build systems that will meet a minimal level of functionality as specified in the document while at the same time providing value added proprietary functionality.

## **7.6 Community Alliance Initiatives**

The ETAAC sees considerable participation from a broad spectrum of taxpayers and tax practitioners needed to achieve the electronic filing goals established by Congress. Simple wage and interest returns account for the majority of electronically filed returns to date. The future growth and success of electronic filing will largely depend on the increased participation of the tax preparer community and the sanction of the small business community.

The tax preparer community is extremely diverse in tax practice procedures and client profile. For some preparers, electronic filing provides efficiencies and incentives. For other preparers, electronic filing presents a burden. There are tremendous opportunities for tax preparer associations to provide constructive input, opinion, and direction into electronic filing process and procedures as they specifically relate to divergent preparer practices and taxpayer profiles.

The small business community, on the other hand, is very sensitive to change, complexity and cost. A seemingly simple initiative will emerge as a compliance nightmare within the small business community.

The advance input and endorsement of the small business community will ensure a successful program. Furthermore, it will provide public assurance the developments of the business electronic filing capabilities are resources well directed.

The ETAAC recommends the formation of two community alliance coalitions or consortiums for the express purpose of working with the practitioner and small business communities via organized agencies and associations who have a vested interest in electronic filing. IRS appointed directors would organize and facilitate the exchange among a consortium of organizations in an effort to obtain valuable input and develop alliances with the IRS. The small business community consortium should include representatives from organizations such as the National Federation of Independent Business, the National Association of Women Business Owners, the National Association of Self-Employed and National Small Business United. The tax preparer community consortium, as noted in Section 4, should include participation from organizations such as the American Institute of Certified Public Accountants, the National Association of Enrolled Agents, the National Association of Tax Practitioners, and the National Society of Accountants. In addition, a representative member of the ETAAC should participate in each alliance consortium.

The ETAAC envisions the tax preparer and small business community consortiums as being the liaison link between the IRS and the organization participants. Anticipated results of consortium communications include:

- identify and eliminate the roadblocks associated with electronic filing;
- implement awards/incentives program to encourage new and continued participation;
- identify and suggest areas of program improvement and application;
- coordinate electronic filing initiatives with respective state and local agencies;
- communicate e-filing initiatives through the consortium organizations; and
- conduct surveys to obtain direct participant feedback regarding e-filing.

The ETAAC believes a community alliance approach to working with the practitioner and business community will go far in advancing electronic filing participation. The participating organizations will applaud such an opportunity for input and direction. Government and community working together will give e-filing strength, momentum, and credibility. Simply being “part of the process” encourages participation and ownership. The endorsement of these organizations will go far in increasing e-filing confidence and participation.

The consortium directors should be employees of the IRS and would be a critical component in the success of such an initiative. The position requires strong public relations and facilitation skills. The business objectives of this position should be specifically defined and appropriate performance measures incorporated. The ETAAC believes the public relations outreach and communicated goodwill via the consortium organizations will produce increased e-filing participation well beyond any public relations campaign communicated directly from the IRS.

**Appendix A  
ETAAC Members  
1999/2000**

Sandra Abalos, Owner, Abalos & Associates\*

Fran Bartlett, President & CEO, Federal Liaison Services, Inc.

Mike Boyle, Vice President, Tax & Audit, Microsoft Corporation

Margaret Drescher, National Advisor, AARP

Keith Dusenbery, Professor of Accounting & Information Systems, Johnson St. College

Edward Feinstein, Vice President, Electronic Filing, H&R Block Tax Services, Inc.

Theron Gilden, President, T.Gilden, Inc.\*

Connie Grimes, President, Grimes Income Tax, Inc.

Mary Harris, Jackson Hewitt Tax Service

Peter Hosokawa, President, First Data Corporation – Cash Tax Inc.\*

Yvonne Kirkendall, EA, Co-owner, W.R. Kirkendall, EA

Charles Lacijan, Senior Technical Advisor, The Implementation Group

Frank Lanza, Director, Processing Services, California Franchise Tax Board

Robert Lewis, President, Tax Back, Inc.

Sue Martin, Professor of Accounting & Taxation, Grand Valley State University

Ike Nooe, Administrator, Info. Resources Mgmt. Div., South Carolina Dept. of Revenue

Helen O'Planick, Partner, HELJAN Associates\*

Bette Rice, Director, Enterprise Technology Services, Merrill Lynch

Elizabeth Seymour, Vice President, Wachovia Bank, N.A.

Bill Shepard, VP & General Manager, Professional Products Group, Intuit, Inc.

John Stauffer, Sr. VP of Product Planning, Ceridian Corporation

John Stoller, President, John D. Stoller, CPA\*

**Electronic Tax Administration Advisory Committee**  
**Charles A. Lacijan, Chairman**

**Appendix B**  
**ETAAC Letter to Robert E. Barr**

May 1, 2000

Robert E. Barr  
Assistant Commissioner  
Electronic Tax Administration  
Internal Revenue Service  
1111 Constitution Ave., NW  
Washington D.C. 20224

Dear Bob:

Your letter of February 22, 2000, distributed to ETAAC members at our March 2 meeting in Washington, elicits our reaction to two proposals in the President's FY 2001 proposed budget:

- 1) a temporary, refundable tax credit of \$10 for e-filing of individual income tax returns; and
- 2) one or more no cost options for preparing and filing individual income tax returns over the Internet.

In particular, you requested our views on how the free Internet filing option could best be achieved and cited the provision in its entirety:

“No later than tax year 2002, the IRS would be required to offer one or more options to the public for preparing and filing individual income tax returns over the Internet at no cost to the taxpayer. If the IRS offered such options through contract arrangements with Authorized IRS e-file Providers, it would be with the assurance that the taxpayer's tax return information would not be used by the Provider without the taxpayer's permission for any purpose other than submission to the IRS.”

Your letter stated that “This proposal does not mean that the IRS will be entering the tax software business. However, it does mean that the IRS will be required to build on the trends that already exist in the industry, which are to offer very low cost or even no cost tax services over the Web. One way that the IRS could implement this provision is by issuing a Request for Proposal (RFP) to the industry requesting vendors to submit proposals ” to meet a number of IRS requirements.

At its March 2 meeting, ETAAC discussed the proposed \$10 refundable tax credit proposal and decided to support this proposal for taxpayers who e-file individual income tax returns.

In response to your letter, we have subsequently considered the proposal for free Internet preparation and filing for individual tax returns. The ETAAC believes that free tax preparation and electronic filing over the Internet for individuals would benefit taxpayers and lead to an increase in electronic filing. Therefore, ETAAC supports this objective, but is concerned that the IRS might attempt to achieve the objective either by competing with the private sector or eliminating robust competition from the private sector.

The IRS Restructuring and Reform Act of 1998 states that “The IRS should cooperate with and encourage the private sector by encouraging competition to increase electronic filing of such returns.” This approach is working well. Existing marketplace competition has already led to a wide number of options that taxpayers can choose, including very low or no cost tax services on the Web from a wide variety of providers—the very trend you indicated in your letter. The number of providers, now over 20, (see the attached list for details) is dramatically increasing every year, forcing strong product development and causing prices to fall dramatically.

The ETAAC believes that the most appropriate actions the IRS can take to provide taxpayers with a wide choice of no cost tax preparation and filing options over the Internet are to: 1) let the competitive market continue to progress, and 2) continue stimulating electronic filing through its creative advertising campaign and making electronic filing convenient to use through such improvements as the acceptance of additional forms and the elimination of paper. These actions will result in increased taxpayer demand for electronic filing which will in turn stimulate the marketplace to create improved and less expensive, even no cost, products, as it has already done in the last several years. The ETAAC applauds Commissioner Rossotti’s testimony to the House Ways and Means Oversight Subcommittee on March 28, 2000 whereby he endorsed this approach.

There are two approaches that the ETAAC believes the IRS should not take. The ETAAC strongly recommends against the IRS developing its own tax preparation software program, either internally or through acquisition. The ETAAC also believes that the IRS should not follow an approach where the IRS issues an RFP or RFA to select a limited number of “Authorized IRS e-file providers” to IRS-specifications. Your letter suggested IRS might use this approach, which ETAAC believes would lessen competition that currently exists in the private sector. If the IRS selects a limited number of providers that will be effectively “co-branded” with it for e-filing, the IRS will indirectly be entering the software business. This situation will result in a huge competitive advantage and perhaps even a monopolistic position for those selected. The IRS should not lessen competition by entering the market and choosing which of the current providers gets the advantage of an “IRS brand”. The ETAAC believes more competition, not less, is important to lowering the price of e-filing and cannot support any implementation that limits or stifles competition in the private sector. The ETAAC would be pleased to work more with the IRS to develop approaches the IRS might take to stimulate the market and increase competition.

The ETAAC supports the goal of a no dollar cost Internet e-filing for all taxpayers and believes it is being achieved currently through free market forces, with even more no cost options available in the future. The marketplace will be further stimulated towards no cost tax preparation and e-filing by enactment of the \$10 tax credit. The key to achieving no cost tax preparation and electronic filing over the Internet is to increase marketplace competition rather than decrease competition by offering IRS software or selecting a limited number of e-file providers for co-branding. If the private sector does not progress to free tax preparation and e-filing in the next several years, as expected, the ETAAC believes the IRS would then be justified in evaluating whether an electronic template is an appropriate and needed tool to promote free e-filing over the Internet. The IRS and ETAAC should track progress in meeting this objective on an annual basis.

The IRS must also recognize that the goal of the private sector is to make a profit and free enterprise does not mean that the private sector must offer its products and services for free. Establishing a goal of no-cost tax preparation and electronic filing ultimately means private sector companies engaging in this practice must obtain something of value, such as exposure to advertising or offers to perform other services, in exchange for free tax preparation and electronic filing. The IRS should ensure that taxpayer privacy rights are not violated, but should not restrict the ability of a consensual exchange between the taxpayer and private sector company to occur in a totally electronic environment with appropriate security safeguards.

The committee has addressed in this letter the two issues you asked it to consider. We are also evaluating a number of other issues that we believe have strategic impact, and will be making recommendations on these issues in our June report to Congress.

Sincerely,

Charles A. Lacijan, Chair  
Electronic Tax Administration Advisory Committee (ETAAC)

Attachment



## Attachment On-line Filing Software Companies

**Note:** The Internal Revenue Service (IRS) has provided links to these companies' web sites. The IRS and the United States Government do not endorse or warrant these companies or their products or services. The decision to use or not to use any of these products and services will not result in any special treatment from the Internal Revenue Service.

On-Line Filing Software	Software Developer	Is Product on Internet?	State On-Line Filing?	Customer Service Telephone Numbers and/or Email Addresses
Preptax.com*	<a href="http://www.preptax.com">Preptax.com</a>	www.preptax.com	KS, PA, ID, NE, MD, NC, NY, WI, ND, CA, IA, MS, LA, MA, RI, DC, WV, CT, IN, GA, KY, OR, OH, NJ, AL, MO, DE, MI, MT, NM	support@preptax.com, 1-918-499-3000
ZapTax*	<a href="http://www.zaptax.net">PDP Tax Service</a>	www.zaptax.net		nm23@aol.com
Automated e1040*	<a href="http://www.e1040.com">e1040.com</a>	www.e1040.com		1-877-404-1040, cs425@e1040.com
FileYourTaxes.com	<a href="http://www.FileYourTaxes.com">Atilla M. Taluy</a>	Yes - www.FileYourTaxes.com	CA	1-805-984-0248, service@FileYourTaxes.com
CompleteTax*	<a href="http://www.CompleteTax.com">CCH, Incorporated</a>	www.CompleteTax.com	ID, KS, LA, MD, NE, NY, PA, WI, CA, NC, IA, MI, SC, CT, OR, AL, GA, IN, VA	support@completetax.com
Taxslayer	<a href="http://www.taxslayer.com">RCS Rhodes Computer Services</a>	Software available for download www.taxslayer.com	KS, LA, MD, NC, PA, MI, NY, IA, MS, SC, DC, IL, WV, CT, MO, AL, KY, MS, NJ, IN, DE, VA, NM	www.taxslayer.com
esmart TAX*	<a href="http://www.esmarttax.com">C &amp; S Technologies</a>	www.esmarttax.com		1-408-935-8468, support@esmartforms.com

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Quicken MacInTax, MacInTax Deluxe, MacInTaxHome & Business	<a href="#">Intuit, Inc.</a>	Software available for download www.macintax.com	ID, KS, LA, MD, NC, NE, NY, PA, UT, CA, IA, MS, ND, MI, MA, RI, SC, DC, IL, WV, CT, CA, OR, MO, AL, IN, DE, MT, VA, NM	1-520-901-3240
Quicken TurboTax, TurboTax Deluxe, Turbo Tax Home & Business	<a href="#">Intuit, Inc.</a>	Software available for download www.turbotax.com	ID, KS, LA, MD, NC, NE, NY, PA, UT, CA, IA, MS, ND, MI, MA, RI, SC, DC, IL, WV, CT, CA, OR, MO, AL, IN, DE, MT, VA, NM	1-520-901-3240
Quicken TurboTax for the Web and TurboTaxEZ	<a href="#">Intuit, Inc.</a>	Yes - www.turbotax.com	ID, KS, LA, MD, NC, NE, NY, PA, UT, CA, IA, MS, ND, MI, MA, RI, SC, DC, IL, WV, CT, CA, OR, MO, AL, IN, DE, MT, VA, NM	1-520-901-3240
H.D.VESTONLINE*	<a href="#">H.D.Vest Technology Services</a>	www.hdvest.com		webmaster@hdvest.com
eTaxsimple*	<a href="#">AJV/Taxsimple</a>	Yes - www.taxsimple.com, support@taxsimple.com		1-973-989-0013
TaxCut	<a href="#">Block Financial Corp</a>	Yes - www.taxcut.com	KS, WI, NC, MI, MA, ID, RI, SC, OR, MO, IN, CA, DE	1-816-504-1500
H & R Block Online Tax Program	<a href="#">Block Financial Corporation</a>	www.hrblock.com/tax_center/doing_my_taxes/index.html	KS, WI, NC, MI, MA, ID, RI, SC, OR, MO, IN, CA, DE	1-816-504-1500

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FileSafe	<a href="#">Tax Systems, Inc</a>	Yes - www.filesafe.com, www.filesafe.net		1-281-895-7014
Microsoft TaxSaver Federal Deluxe, * Microsoft TaxSaver Federal Standard, * Microsoft TaxSaver Federal Trial*	<a href="#">Microsoft</a>	Software available for download - taxsaver.msn.com		1-425-454-2030, 1-800-936-5700, http://support.microsoft.com
Tax1	<a href="#">Etax Corporation</a>	Yes - www.Tax1.com		1-301-912-3450, cpa@etaxonline.com
AutoTax	<a href="#">TaxLink, Inc.</a>	Software available for download www.autotax.com		1-614-538-5497, www.autotax.com
TaxACT	<a href="#">2nd Story</a>	Software available for download www.taxact.com	IA, NY	1-800-573-4287
Nelco Tax Wizard	<a href="#">Nelco</a>	Yes - www.nelcoinc.com, pefsupport@nelcomail.com		-920-337-2034
AMTax	<a href="#">AM Software</a>	Order - www.amtax.com, support@amtax.com		1-800-859-8537
Tax Preparer 2000 by HowardSoft*	<a href="#">HowardSoft</a>	www.howardsoft.com, support@HowardSoft.com		1-858-454-0121
UDS ELECTro TAX Individual	<a href="#">UDS ELECTro TAX LLC</a>	Yes - www.udstax.com		1-410-730-8460, hondo@udstax.com
NetTax-on-line	<a href="#">Full Duplex Systems, Inc.</a>	Yes - www.nettaxonline.com	MD	1-877-892-8470

\* New for filing season 2000

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